201007077

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

NOV 24 2009

T:EP:RA:T4

U.I.L. 162.02-00, 401.04-00, 402.00-00, 404.00-00, 415.02-00, 4972.04-03

xxxxx
xxxxx
xxxxx
xxxxx

Legend:

Employer M = xxxxx

Plan X = xxxxx

Individual B = xxxxx

Company C = xxxxx

Date 1 = xxxxx

Date 2 = xxxxx

Year 1= xxxxx

Date 3 = xxxxx

Amount N = xxxxx

Date 4 = xxxxx

Date 5 = xxxxx

Date 6 = xxxxx

Amount O = xxxxx

Company D = xxxxx

Date 7 = xxxxx

Date 8 = xxxxx

Company E = xxxxx

Amount P = xxxxx

Amount Q = xxxxx

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This is in response to a request dated April 14, 2009, as amended by correspondence dated July 24, 2009, submitted by your authorized representative on your behalf, concerning the characterization and tax consequences of certain proposed payments to a defined contribution plan.

The following facts and representations in support of your request have been submitted under penalties of perjury:

Employer M sponsors Plan X for the benefit of its employees. Plan X is a defined contribution plan, established and originally effective Date 1. Plan X was restated on Date 2.

Plan X is represented to be qualified under section 401(a) of the Internal Revenue Code ("Code") and its trust exempt from tax pursuant to section 501(a) of the Code. Plan X is comprised of a profit-sharing component (the "P-S component") and a qualified cash or deferred arrangement described under section 401(k)(2) of the Code (the "401(k) component").

Employer M makes employer contributions on a discretionary basis to the P-S component of Plan X. Employer M makes employer contributions on a matching basis to the 401(k) component of Plan X. Participants contribute to the 401(k) component on a pre-tax basis.

Decisions regarding investment of the P-S component of Plan X are made by Employer M.

Decisions regarding investment of each Plan X participant's interest in the 401(k) component of Plan X are made by each participant with respect to his or her individual account.

In Year 1, the investment management of a portion of the assets of the P-S component of Plan X was shifted to Company C, a registered broker-dealer. For each year of the 13 years following Year 1, Employer M made annual discretionary contributions to the P-S component. For each year of the 13 years following Year 1, the investment of Employer M's annual contributions to the P-S component were invested with Company C. Employer M represents that during this period it received regular account statements from Company C, the accounts showed positive returns, distribution requests were honored on a timely basis, and other related operations for this account were in order.

On Date 3, Individual B, the president and founder of Company C, was charged publicly with engaging in a scheme which had resulted in the widespread depletion of assets which had been placed under the management of Company C for investment. One day following Date 3, the Securities Investor Protection Corporation (SIPC) took control of Company C. Three days later, Company C filed for protection under Chapter 11 of the Bankruptcy Act.

Upon learning of the charges against Individual B and of the status of Company C, Employer M commenced a campaign to protect the interests of affected Plan X participants. To that end, Employer M filed a claim with the SIPC on behalf of Plan X and on behalf of each participant in Plan X.

Employer M also notified and requested coverage from its employee benefits plan administration liability insurer, fiduciary liability insurer and crime loss insurer. Employer M's corporate bylaws provide that its officers are entitled to indemnification from Employer M if a breach of fiduciary duty were found to have occurred.

Employer M's commitment to retrieve plan assets and restore the accounts of P-S component participants is overshadowed by prediction that only a small portion of the investments lost by Company C will be recovered. Depletion of the assets of thousands of accounts of investors who had invested with Company C over a period of several decades has overwhelmed the claim process under SIPC.

The total amount of employer contributions to the P-S component which were invested with Company C between Year 1 and Date 3 for affected participants who suffered loss due to the Company C fraud is Amount N.

It is represented that no participant 401(k) or matching contributions to the 401(k) component of Plan X were invested with Company C.

Employer M represents that it became concerned that participants would initiate legal action against it. In addition, on Date 4, Employer M received notice from the U.S. Department of Labor (DOL) that the DOL was conducting an investigation of Plan X to determine whether any person had violated Title I of Employee Retirement Income Security Act of 1974 (ERISA). Enclosed with the notice was a subpoena requiring Employer M to produce documents and records.

In response to these events, Employer M proposes to make a restorative payment to Plan X that would put the P-S component of Plan X in the financial position it would have been in had employer contributions been invested other than with Company C during the relevant period. The proposed restorative payment is intended to apply to all current and former participants whose accounts were adversely affected by the investment with Company C. Effective Date 5, an addendum to the adoption agreement to Plan X was amended to permit Employer M to make a restorative payment, as defined in section 1.415(c)-1(b)(2)(ii)(C) of the Income Tax Regulations (Regulations), to the P-S component of Plan X.

On Date 6, as an interim remedial measure, Employer M made a cash payment of Amount O, representing a material percentage of the Employer M contributions made to Plan X and invested in Company C, adjusted by an earnings rate that Plan X would have experienced had it invested in a typical blend of securities during the period. The determination as to the appropriate earnings rate was made by Company D, an independent financial consulting firm which advises plan fiduciaries with respect to plan investment matters, and which was engaged by Employer M for this purpose.

After Company D determined the appropriate earnings rate, the specific allocations to participant accounts was performed by Company E, an independent fiduciary engaged to complete that task and determine whether the remedial plan as a whole is fair to participants and serves their best interests. Prior to this engagement, an affiliate of Company E served as an investment advisor to the 401(k) component of Plan X with respect to the selection of investment options available to participants. Employer M represents that neither Company D nor Company E has other relationships with Employer M, and each has acted as an independent consultant and as an independent fiduciary, respectively, with respect to this matter.

Employer M represents that the interim remedial payment to Plan X in the amount of Amount O on Date 6 has been invested within Plan X and will be allocated to affected participants' accounts, adjusted by earnings or losses, upon receipt of a favorable ruling.

With respect to the remaining Employer M contributions lost due to the Company C fraud, as adjusted by the earnings rate determined by Company D, plus an amount representing forfeitures for the period at issue, Employer M proposes to make additional restorative payments to Plan X. The first additional restorative payment would be in the amount of Amount P and allocation would be deferred until receipt of a ruling from IRS. The amount of the final restorative payment would be an amount that when combined with the initial and additional restorative payments would equal Company M contributions made to Plan X and invested with Company C with respect to affected Plan X participants, adjusted for earnings and losses at the rate determined by Company D, with such amount to be allocated to affected participants in accordance with the calculations prepared by Company E. The final restorative payment amount will be increased by

Amount Q, which represents no less than the total amount of all forfeitures for the relevant period.

Based on the preceding facts and representations, your authorized representative has requested the following rulings on your behalf:

1. The payments made pursuant to the proposed transaction will not constitute a "contribution" or other payment subject to the provisions of either Code section 404 or Code section 4972.

2. The payments made pursuant to the proposed transaction will not adversely affect the qualified status of the Plan pursuant to either Code section 401(a)(4) or Code section 415.

3. The payments made pursuant to the proposed transaction will not, when made, result in taxable income to affected Plan participants or beneficiaries under Code section 402(a)(1).

4. The payments made pursuant to the proposed transaction will be deductible by the Employer under Code section 162 as an ordinary and necessary business expense.

With respect to ruling requests one, two and three, section 401(a)(4) of the Code provides generally that the contributions or benefits provided under a qualified plan may not discriminate in favor of highly compensated employees.

Section 402(a) of the Code generally provides that any amount actually distributed to any distributee by an employees' trust described in section Code 401(a) which is exempt from tax under Code section 501(a) shall not be taxable to a participant until actually distributed to the participant.

Section 404(a) of the Code generally provides that contributions paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, if otherwise deductible, are deductible under section 404, subject to the limitations under section 404(a).

Section 415(a) of the Code provides, in part, that a trust which is part of a pension, profit-sharing or stock bonus plan shall not constitute a qualified trust under Code section 401(a) if in the case of a defined contribution plan, contributions and other additions under the plan with respect to any participant for any taxable year exceed the limitations of section 415(c).

Section 1.415(c)-1(b)(2)(i) of the Regulations provides that the term "annual additions" includes employer contributions credited to the participant's account for the limitation year. Section 1.415(c)-1(b)(2)(ii)(C) of the Regulations provides that a restorative payment that is allocated to a participant's account does not give rise to an annual addition for any limitation year. For this purpose, restorative payments are payments made to restore losses to a plan resulting from actions by a fiduciary for which there is reasonable risk of liability for breach of a fiduciary duty under Title 1 of ERISA or under other applicable federal or state law, where plan participants who are similarly situated are treated similarly with respect to the payments. Generally, payments to a defined contribution plan are restorative payments only if the payments are made in order to restore some or all of the plan's losses due to an action (or a failure to act) that creates a reasonable risk of liability for such a breach of fiduciary duty (other than a breach of fiduciary duty arising from failure to remit contributions to the plan). This includes payments to a plan made pursuant to a Department of Labor order, the Department of Labor's Voluntary Fiduciary Correction Program, or a court-approved settlement to restore losses to a qualified defined contribution plan on account of the breach of fiduciary duty (other than a breach of fiduciary duty arising from failure to remit contributions to the plan). Payments made to a plan to make up for losses due merely to market fluctuations and other payments that are not made on account of a reasonable risk of liability for breach of a fiduciary duty under Title 1 of ERISA are not restorative payments and generally constitute contributions that give rise to annual additions.

Section 4972 of the Code imposes on an employer a ten percent excise tax on the amount of the nondeductible contributions made to any "qualified employer plan", including a plan qualified under Code section 401(a).

Section 4972(c) of the Code defines "nondeductible contributions" as the excess (if any) of the amount contributed for the taxable year by the employer to or under such plan over the amount allowable as a deduction under Code section 404 for such contributions (determined without regard to subsection (e) thereof), and the amount determined under subsection (c) for the preceding year reduced by the sum of the portion of the amount so determined returned to the employer during the taxable year and the portion of the amount so determined deductible under Code section 404 for the taxable year (determined without regard to subsection (e) thereof).

Revenue Ruling 2002-45, 2002-2 C.B. 116 ("Rev. Rul. 2002-45"), applies a facts and circumstances test to determine whether a payment to a plan qualified under Code section 401(a) is a restorative payment or a contribution to the plan. Under Rev. Rul. 2002-45, payments made merely to replenish a participant's account in a defined contribution plan after investment losses are to be treated as contributions. On the other hand, payments that are made to restore some or all of the account's losses due to an action (or failure to act) that creates a reasonable risk of liability are restorative payments. In addition, in order to be a restorative payment, the payment does not need to be the result of legal action; it only needs to be made as a result of a reasonable determination that there is a reasonable risk of liability. Rev. Rul. 2002-45 also provides that the amount of a restorative payment cannot exceed the initial amount of the investment.

Applying the reasoning of Rev. Rul. 2002-45 in this case, Employer M has made a reasonable determination that there was a reasonable risk of liability for breach of fiduciary duty as a result of the losses sustained by Plan X through the fraudulent action of Company C. In addition, the payments which Employer M intends to make to Plan X are designed to ensure that the affected participants of the P-S component of Plan X recover a significant portion of their account balances and that such participants are restored to a position similar to that in which such participants would have been in the absence of Employer M's decision to invest assets of the P-S component of Plan X with Company C. Thus, it is reasonable to characterize this payment as a restorative payment rather than as a plan contribution or as an annual addition.

As indicated by the facts of this case, the restorative payments will be allocated to all affected participants according to the value of the accounts of the affected Plan X participants as determined by Employer M and as calculated independently by Company E.

Thus, based on the above, we conclude that the restorative payments both paid and to be paid pursuant to the proposed transaction will not constitute a contribution or other payment subject to the provisions of either Code section 404 or Code section 4972; will not adversely affect the qualified status of Plan X pursuant to either Code section 401(a)(4) or Code section 415; and will not, when made, result in taxable income to affected Plan X participants or beneficiaries under Code section 402(a)(1).

With respect to ruling request four, section 162 of the Code provides that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

The situation in which Employer M finds itself arose in the ordinary course of its trade or business. There is no serious question of its business origin. Substantial authority holds that payments of the type described herein are ordinary and necessary and therefore deductible as business expenses. See Welch v. Helvering, 290 U.S. 111 (1933); Laurence M. Marks v. Commissioner, 27 T.C. 464 (1956), acq., 1966-2 C.B. 2; Old Town Corp. v. Commissioner, 37 T.C. 845, (1962), acq., 1962-2 C.B. 5.

Therefore, with respect to ruling request four, we conclude that the restorative payments made by Employer M to Plan X are deductible by Employer M under Code section 162 as ordinary and necessary business expenses.

This ruling is based on the assumption that Plan X otherwise meets the requirements of section 401(a) of the Code and that its related trust is tax-exempt within the meaning of Code section 501(a). No opinion is expressed as to the Federal income tax consequences of the transactions described above under any other provisions of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter ruling is being sent to your authorized representative.

If you wish to inquire about this ruling, please contact xxxxx, I.D. # xxxxx, by telephone at xxxxx. Please address all correspondence to SE:T:EP:RA:T4.

Sincerely yours,

Laura B. Warshawsky, Manager
Employee Plans Technical Group 4

Enclosures:
Deleted copy of ruling letter
Notice of Intention to Disclose

cc: xxxxx
xxxxx
xxxxx
xxxxx
xxxxx